REVIEW

OF

Mr. HOOPER'S PAMPHLET

ON

SPECIE RESERVES.

BY

JOHN AMORY LOWELL.

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CURRENCY.

No one, in this country at least, will deny the great convenience, commercial and domestic, of a mixed currency. The substitution, to a limited extent, of paper for the precious metals, is a labor-saving invention; and no people, who have once experienced its advantages, will voluntarily forego them.

The issuing of coin, stamped with a known and invariable value, is a privilege reserved to the sovereign. Where paper is made a legal tender, it participates in the same character; and it becomes the bounden duty of the sovereign, or the legislature, if the privilege of issuing such paper is delegated to one or more institutions, to grant it under such restrictions as shall render it certain that the paper so issued shall have a like known and invariable value.

Where it is not made a legal tender, no such bounden duty exists; still, if it has been deemed

expedient to restrict the right of issue to certain persons or corporations, and thus to create a monopoly in their favor, it may not be unreasonable, and public policy may require, that restrictions of a like nature should, in this case also, accompany the grant.

Here the duty and expediency of interference end. All legislative enactments beyond this point are trammels imposed arbitrarily on the freedom of commercial action.

While, therefore, we should consent, nay, insist, that a currency sanctioned by the state should be guarded by suitable provisions for the public safety, we should be no less solicitous that these provisions should not be of a nature and to an extent more than adequate to the complete fulfilment of this end.

For this purpose it is important that the true nature and effect of these provisions should be understood; and that if really tending, however necessary, to the diminution of profit and the restriction of trade, that tendency should be fully appreciated.

It is on this account that I propose to examine the theories set forth in a remarkable pamphlet on the effect of the laws regulating the amount of specie in banks, by Samuel Hooper, Esq.

I shall at present confine myself to this particular question; the more extensive subject of the laws of

Massachusetts concerning banking deserve, and may, perchance, hereafter receive, more thorough consideration.

The pamphlet in question is written in a bold and vigorous style; there is no misconceiving the author's meaning; and while I differ entirely from him in some of his views, I should be the last to refuse my sympathy to the conservatism of his intentions.

The general exposition of the principles of banking is such as has received the sanction of all writers on the subject; it is not my intention to analyze it here.

One or two ideas, however, are startling, and, so far as I know, original. They are brought forward with great emphasis, and are designed "to influence the action of the States which control the Banking laws." (Preface, p. iv.)

The first of these that I shall consider is, that the greater the reserves of specie in the banks, the greater will be the loans that they can maintain, and the greater, consequently, the profits of the shareholders.

This principle is stated without limit or qualification.

"It can be made obvious that a large amount in the vaults of the banks is more profitable to their stockholders and more beneficial to the community, as it enables the banks to sustain a larger amount of loans." (p. 6.)

"It may seem paradoxical to state that banks can give greater facilities to the business community by having larger amounts loaned out, and hold at the same time larger amounts of specie in their vaults; but nevertheless it is true." (p. 6.)

"Any one familiar with the condition and the profits of the banks in Boston and New York can judge, from the foregoing statement, whether the large amount of specie, which the law of Louisiana renders necessary to the banks in New Orleans, impairs their profits or their ability to accommodate the public." (p. 12.)

"It cannot, therefore, be said that the banks are losing the interest on the amount of specie in their vaults; for the more they have of it, the more ability they will have to increase their loan." (p. 29.)

These quotations will suffice to show that the principle is laid down without limit or qualification.

Thus stated, it is manifestly false. For supposing a bank to keep specie equal in amount to its capital and liabilities, it could not loan one dollar, and would pay its rent, salaries, and expenses *en pure perte.*

And this is a supposition that we have a right to make; else the proposition is not true without qualification. In legislation, as in science, it will not do to lay down a broad, general principle, without being prepared to follow out its strict logical consequences.

Let us go a step further. The nearer a bank comes in its specie reserves to the point above supposed, the smaller will be its profits. The limit is the point where public confidence would begin to be shaken in the ability of the bank to meet its liabilities in specie on demand.

This question of confidence brings me to the only *à priori* argument that Mr. Hooper adduces, or indeed could adduce, in favor of his opinion.

"The Louisiana system," he says (p. 11), "creates confidence, while that of New York and the New England States cannot secure general confidence."

Does Mr. Hooper mean to say that the banks in Boston do not inspire general confidence? — that any merchant or capitalist is afraid to intrust his money to their keeping? This is easily tested. For if true, this money must be hoarded. It must be in cellars or in safes in the shape of gold and silver coin. Do any such hoards exist? If not, there is no want of confidence in the banks, and Mr. Hooper's solitary *à priori* argument falls to the ground.

With regard to the teachings of experience, three examples are adduced. That of our own banks, that of the banks of New Orleans, and, somewhat more cursorily, that of the Bank of England.

I shall examine each in turn.

Throughout the evidence adduced concerning our own banks there underlies a fundamental error.

When philosophers undertake to deduce the laws governing the phenomena of the natural world from observations, they take great pains to give to these observations as wide a range as possible, that they may lessen the influence of abnormal cases.

In like manner, the tables of mortality, on which all life-insurance is founded, are made up from a long series of careful records. The experience of a single year would be utterly deceptive.

Yet this is precisely what is done with respect to our banks. In almost, if not quite, every instance, the year 1858 is the standard, the Procrustean bed on which all other years are to be stretched. Will any one maintain that the business of the country was in its natural state in 1858? Had the country recovered from the effect of the crisis? Had commerce resumed its natural development?

If it had, how is this fact to be explained, that a decline of specie in the banks (p. 6) between January and December, 1859, of $3,592,258, was followed by a decline in the loan of only $600,000, instead of more than $10,500,000, as should have been the case in accordance with Mr. Hooper's theory? If business was in its natural state, no more triumphant refutation can be imagined. If it was not, all argument derived from the state of the loans or the reserves of specie in that year can only lead to error.

I do not know that any appeal is made in this pamphlet to our own experience, disconnected with that year, unless it be in the following passage: —

"An examination and comparison of the published reports of the condition of the banks in different years will show, that their loans are usually highest when the amount of specie is large." (p. 7.)

I presume that the amount of specie is large, when the exchanges are in favor of the country, that is, in times of commercial prosperity; to attribute the maintenance of the loan at such times to the specie reserves is very much like this reasoning: — I have always observed that in fine weather there were most pedestrians abroad; it is therefore undeniable, and proved by all experience, that pedestrians have a direct tendency to produce fine weather.

On p. 37 occurs a remarkable passage touching the banks of the United States in general. After comparing their condition in 1857 and 1858, the author adds: —

"The reduction of over one hundred millions of dollars, equal to nearly one quarter of the whole, within a single year, would seem to account sufficiently for all the financial disaster and depression in business that have occurred in the United States since the summer of 1857."

One would think that this withdrawal of capital

had, in Mr. Hooper's view, worked mischief enough; but he is not contented unless he *annihilates* it; for he goes on to say: —

"Over one hundred millions of capital was withdrawn from the use of the community within one year, and probably within the space of a few months; not withdrawn from particular branches of industry to be employed in other ways, but absolutely annihilated, because of the insufficiency of the specie in the banks."

Determined that there shall be no misapprehension as to his opinion of the causes of the crisis he reiterates (p. 39): —

"It is not, perhaps, venturing too much to say, that if the New York banks had, for the twelve months preceding the suspension of specie payments, been in the condition, as regards the amount of their specie, that they were in during the subsequent twelve months, the unfortunate interruption of the business of the country which occurred in 1857, with all its consequent distress and ruin to merchants and others, would have been avoided."

Never was there a more singular substitution than this of *cause* for *effect*. The disastrous crisis of 1857, extending as it did, with greater or less severity, over the whole commercial world, rendered the use of capital unprofitable, and, of course, diminished the bank credits in 1858. It was,

surely, not the want of specie in that year that kept the loans so low. On the contrary, capital was over-abundant. The rate of interest fell to below five per cent, and even then it was not easy to find borrowers. It was not capital that was withdrawn or annihilated; the difficulty was, that nobody could be found to employ it.

The causes of that crisis, so severe and so universal, have never, so far as I know, been satisfactorily explained; but I feel persuaded that the condition of the banks, though it may have occasioned, or contributed to, the suspension, had little or nothing to do with the crisis itself.

I now come to the banks in New Orleans.

Concerning these, Mr. Hooper states that since 1842 they have been required by law to keep specie in their vaults to the amount of one third of their liabilities; to keep the other two thirds invested in paper not having over ninety days to run, and not renewable; and that no restraint is laid on the investment of the capital. (p. 8.)

They are not limited, therefore, apparently, by any usury law, so far as this portion of their loan is concerned, nor does it seem that the amount of their loan, nor the amount of their circulation, nor the rate of exchange that they may lawfully take, is in any way restrained. In short, they are very much less trammelled by useless legislation than our banks.

The profits of the banks in New Orleans are specified on page 12, and they appear to average at least twelve per cent per annum.

From this state of things Mr. Hooper infers:—

"This law of Louisiana carried their banks safely through the panic of 1857 without distressing the customers of the banks; in fact, the financial panic of 1857 scarcely affected the monetary affairs of New Orleans." (p. 9.)

"The New Orleans banks can, by the same general course of business, and with double the amount of specie in their vaults, accommodate their customers, the merchants and others, with a larger amount of loans, and earn much larger profits for their stockholders, than the New York city or the Boston banks." (p. 10.)

Are these inferences just?

In the first place, cotton, the great staple in New Orleans, nearly escaped the effects of the crisis, and there was, in consequence, scarcely any panic there in 1857.

In the second place, no just comparison can be made between the business of New Orleans and that of Boston, so different in kind and in amount.

An example will show the fallacy of such comparisons.

The Union Bank of Australia has a capital of £1,000,000.

Its liabilities, June 30, 1859, were	£5,181,324
Specie, cash balances and bullion, ...	1,001,550
Loan, ...	4,942,745

Semiannual dividend, 8 per cent.

Ratio of specie to liabilities, 19.3 per cent.

Loan, five times the capital.

Now, in comparing the banks of New Orleans with those of Boston, Mr. Hooper argues that the loans are less and the profits less, in Boston, *because* of the greater specie reserves required by law to be kept by the banks in Louisiana.

Let us apply this style of reasoning to the case of the Bank of Australia, as compared with the same New Orleans banks. The impertinent and useless requisitions, we might say, of the Louisiana law, while they reduce the accommodation of the public in the ratio of 95 to 52, at the same time diminish the profits of the shareholders as 16 to 12.

I beg that it may be remembered that this is not my reasoning, but Mr. Hooper's.

In the third place, twelve per cent dividends do not remunerate capital better in New Orleans than eight per cent in Boston. Probably not so well. At all events, either capitalists are not so desirous of establishing banks there as here, or charters are granted with much more reluctance. From whichever cause it may arise, the banking capital is much less in proportion to the business to be done.

The condition of the banks in New Orleans, exclusive of the free banks, December 31, 1859, was, —

Capital invested in long loans, ...	$ 18,917,600
Short loans, ...	26,000,000
Exchange, ...	7,000,000
Total, ...	$ 51,917,600

Nineteen millions of capital to supply a demand of fifty-two millions.

I have not included an item of "distant balances," of one and a half millions, although Mr. Hooper tells us (p. 11) that these balances are usually on interest.

The Boston banks, with a capital of thirty-five millions, sustain a loan of only sixty millions. The simplest operation in arithmetic will show that, if the Boston banks could do as much business in proportion to their capital as the New Orleans banks, they would earn about twelve and a half per cent. Yet they have not the advantage of six and a half to eight per cent on that portion of their loan representing the capital, as have the banks in New Orleans (p. 55), nor of distant and profitable exchange. So that, after all, the figures show, as might have been foreseen, the effect of the law of Louisiana in lessening the profit of the banks.

To the Bank of England Mr. Hooper applies, no doubt by inadvertence, a standard, the insufficiency of which he has himself distinctly admitted.

"The amount of specie a bank holds," he says (p. 14), "is important only in reference to the amount of its liabilities which are due and payable on demand."

Yet in speaking of the Bank of England (p. 32, and again, p. 48) he compares the reserves to the capital, without giving us the liabilities of that institution.

I will endeavor to supply the deficiency. The capital of the Bank of England is £14,553,000.

Its deposits, January 11, 1860, were . .		£ 21,920,833
Circulation, ...	£ 30,002,060	
Less issued, but not employed,	8,170,740	21,831,320
		£ 43,752,153

Gold and bullion, £16,224,129, or about 37 per cent on the liabilities.

The Bank of England practically furnishes the specie basis for the monetary and commercial transactions of the whole kingdom, government as well as people; and 37 per cent on its liabilities is found to be amply sufficient; yet Mr. Hooper thinks that 50 per cent, if not absolutely necessary, would not be extravagant for New York, which sustains no such relations.

"When the New York city banks," he says (p. 47), "are by law obliged to keep in their vaults an amount of specie equal to one half, or at least to one third, of their liabilities for circulation and

deposits, (and not until then,) they will command unlimited confidence throughout the United States."

This statement of the Bank of England, though showing specie reserves a little higher than those required by law to be kept by the New Orleans banks, but not higher than they actually hold, scarcely justifies the language: —

"It is these vast amounts of specie, as they appear to us, that give to the Banks of England and of France the ability to sustain an amount of liabilities, and to furnish to the people and to the governments of those countries an amount of loans, so much beyond what our banks can do." (p. 32.)

"When the specie in the Bank of England," says Mr. Hooper (p. 45), "is reduced below £10,000,000, it is considered almost a public calamity, and, whenever it occurs, the commerce of the whole world is affected by it."

This is perfectly true; but the specie bears to the liabilities, in that case, a ratio less than 22.85 to 100; and it is to be borne in mind that the Bank of England is the great repository of specie for the whole kingdom; they are the first to sound the alarm; and it is not, therefore, until all other sources are exhausted, that a serious drain on the Bank begins.

At the same time the discounting operations of the Bank of England do not probably represent one

half of those of the incorporated companies in London alone.

To illustrate this, I will refer to one example, not a selected one, but the only one that I happen to have at hand.

The Bank of London, with a capital of £300,000, has liabilities to the amount of £1,599,140. Cash in hand and *on call* of £202,856, or about 12.69 per cent on the liabilities.

If the banks in London have aggregate liabilities equal to those of the Bank of England, and specie reserves proportionate to those here cited, which, I repeat, is not a selected example, it is manifest that an amount of coin equal to one fourth of the liabilities is found sufficient to sustain the business of London.

It will be observed that the liabilities of the Bank of London exceed *five* times, and those of the Bank of England *three* times, the capital,—while in Massachusetts they are practically restricted to an amount not exceeding the capital (all excess beyond this being necessarily in coin). Now as the capital is in effect a safety fund for the creditors, it is obvious that the creditors of a bank in Boston have a much greater guaranty from eventual loss, under the existing laws, than have those of the Bank of England. And this would be true, even if they had no specie reserves whatsoever.

I have endeavored to meet, and, I trust, succeeded in meeting, Mr. Hooper's argument on this first point with entire candor. I have not, knowingly, omitted to give full force to every point that he has assumed.

I now pass to the second theory on which I designed to comment, to wit, that "the deposits, as well as the circulation, of banks, are mainly created by the banks themselves," — an opinion on which the author evidently lays great stress, and to which he assigns a prominent place in his Preface.

This opinion certainly needs proof.

For, first, as to circulation. Every man is conscious to himself of keeping no more money about him than is required by his daily wants, or, if he is a retailer, by the daily necessities of his trade; the whole circulation, certainly all that portion of it on which the banks would venture to discount, is made up of the aggregate of the sums so retained. It is difficult to see how any action of the banks can induce any man to increase, materially, the sum which he chooses, or is obliged, thus to keep in his possession.

The same reasoning applies to the deposits. Every individual, every firm or corporation, keeps habitually a certain deposit, proportioned to the daily requisitions of his or their business, which is not allowed greatly to increase. Discounts are ob-

tained to meet accruing liabilities, and to such they are immediately applied. When money is scarce, the deposits usually increase a little, because prudent men prefer losing a few day's interest to incurring the slightest risk of being unable to meet their liabilities. Here again it is not easy to see how any action of the banks can materially increase the sum of these deposits.

These truths are very elementary; and I should deem it almost impertinent to insist upon them, were it not for the gravity with which the contrary is urged as the result of experience:—

"One of the apparent mysteries of banking," says Mr. Hooper (p. 14), "that is not generally understood, is, that the deposits and circulation usually increase or diminish as the loans of the banks increase or diminish."

This is another curious substitution of cause for effect. There is no need of resorting to mystery or paradox.

> "Nec deus intersit, nisi dignus vindice nodus
> Inciderit."

Let us reverse the statement. The loans of the banks usually increase or diminish as the deposits and circulation increase or diminish. This is simple and intelligible; neither mystical nor paradoxical; and every bank manager knows that it is the true order of events.

Again, " It is thus apparent that the deposits, as well as the circulation, are mainly created by the banks." (p. 16.)

And yet again, " The deposits and the circulation are mainly the result of their loans, and their specie is the basis on which their ability to loan rests." (p. 17.)

Passing over the looseness of this last assertion, in which the capital as a basis of the loans is entirely ignored (for I have no desire to avail myself of accidental inaccuracies), let us see how far experience bears out this theory.

The unanimous assurance of all the country bankers examined before successive Parliamentary committees is, in the words of one of them, Mr. Fullarton: " The amount of their issues is exclusively regulated by the extent of local dealing and expenditure in their respective districts, fluctuating with the fluctuations of production and price; and they neither can increase their issues beyond the limits which the range of such dealing and expenditure prescribes, nor diminish them, but at an almost equal certainty of the vacancy being filled up from some other source."

To the same effect Mr. Tooke, in his pamphlet on the Currency Principle (p. 122), says, " that it is not in the power of banks of issue, including the Bank of England, to make any direct addition to the

amount of notes circulating in their respective districts, however disposed they may be to do so."

Professor Bowen, Principles of Political Economy (p. 353), says, "The amount of the deposits depends upon the number of the customers of the bank, and upon the nature and extent of their business;" and again, "The excess of the circulation over the specie reserve, though generally supposed to be variable, is in truth as much a fixed quantity as either of the others."

Very much to the same effect is the statement of Mr. Latham, deputy-governor of the Bank of England, in a passage quoted by Mr. Hooper (p. 43), although, apparently, without appreciating its import: —

"If there were no Bank of England, or no banks at all, no gold and no silver, — for these are mere ripples on the surface, — the great stream of interchange might still roll on, the same relations between borrower and lender might still exist, and the issue of their transactions be not very different from what it is under the present artificial and greatly overrated arrangements."

Surely, if the business of the country would be not very different did no banks exist, it cannot be in the power of those institutions, at their mere will and pleasure, materially to regulate the amount of that business.

One word, in conclusion, on the general deductions of the pamphlet. With the same inconclusiveness of reasoning with which, on p. 24, Mr. Hooper infers that a persevering *contraction* of the loans in 1859 would have *increased* their amount at the end of that year; he says (p. 33) that, if his views were carried out, "the foreign trade of the country would be made to encourage and foster domestic industry, as it ought, instead of being, as much of it is now, to a great extent, antagonistic to home industry."

The greatest obstacle to the development of domestic industry is admitted to be excessive importation; but how is this to be checked by the same measures that are, we are told, to enlarge the loans? Miraculous, truly, must be that legislation which makes money scarce and plenty at the same time in the same community!

I am fully aware of the disadvantage under which I oppose, off-hand and almost without time to consult authorities, a writer who has maturely elaborated his views on this his favorite topic of inquiry. I submit, nevertheless, these reflections to my fellow-citizens, in entire confidence that the truth will ultimately prevail over rash though brilliant speculations.